

Letter of Findings: 04-20120300
Gross Retail Tax
For the Years 2008, 2009, and 2010

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ISSUES

I. Non-Legend Drugs – Gross Retail Tax.

Authority: IC § 6-2.5-1-17; IC § 6-2.5-1-17(3); IC § 6-2.5-1-2; IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-1(a); IC § 6-2.5-3-2(a); IC § 6-2.5-4-1(b), (c); IC § 6-2.5-5-19 (2003); IC § 6-2.5-5-19(d); IC § 6-2.5-5-19 (1980); IC § 6-2.5-5-19(d)(2); IC § 6-8.1-5-1(c); IC § 16-42-19-3; [45 IAC 2.2-5-35](#) (1982); [45 IAC 2.2-5-36](#) (1982); *Rhoades v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); *Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629 (Ind. Tax Ct. 1999); *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282 (Ind. Tax Ct. 1999); *General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399 (Ind. Tax Ct. 1991); *Indiana Dept. of State Rev. v. Kimball Int'l Inc.*, 520 N.E.2d 454 (Ind. Ct. App. 1988); *USAir, Inc. v. Ind. Dep't of State Revenue*, 623 N.E.2d 466 (Ind. Tax Ct. 1993); *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96 (Ind. Ct. App. 1974).

Taxpayer argues that its purchases of non-legend drugs are exempt from sales/use tax.

II. Medical Supplies and Equipment – Gross Retail Tax.

Authority: IC § 6-2.5-5-18; IC § 6-2.5-5-18(a); IC § 6-8.1-5-1(c); [45 IAC 2.2-5-27](#); [45 IAC 2.2-5-27\(b\)](#); [45 IAC 2.2-5-28](#); [45 IAC 2.2-5-36](#); [45 IAC 2.2-5-36\(a\)\(4\)](#); [45 IAC 2.2-5-36\(a\)\(5\)](#); Sales Tax Information Bulletin 48 (August 2008); Letter of Findings 08-0531 (February 2, 2009); Letter of Findings 09-0192 (November 30, 2009); Letter of Findings 09-0223 (November 30, 2009); Letter of Findings 05-0297 (December 1, 2006); Letter of Findings 97-0111 (August 31, 1998); Revenue Ruling 2010-01ST (January 11, 2010); Revenue Ruling 2010-02ST (February 18, 2010); Revenue Ruling 2009-16ST (December 1, 2009); Revenue Ruling 1998-02 (February 6, 1998).

Taxpayer maintains that its purchase of various medical supplies and equipment were not subject to sales or use tax.

STATEMENT OF FACTS

Taxpayer is a limited partnership that operates nursing homes both in this state and outside Indiana. The nursing homes provide long-term and rehabilitative health care. The Department of Revenue ("Department") conducted an audit review of Taxpayer's tax returns and business records. The audit resulted in the assessment of additional sales/use tax. Taxpayer disagreed with portions of the assessment and submitted a protest to that effect. An administrative hearing was conducted and this Letter of Findings results.

I. Non-Legend Drugs – Gross Retail Tax.

DISCUSSION

The audit found that Taxpayer's purchases of "non-prescription lotions and ointments" were subject to sales and use tax. Taxpayer disagrees maintaining that "non-legend" drugs are exempt from sales use tax.

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b).

Indiana also imposes a complementary excise tax called the "use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). Use means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). The use tax is functionally equivalent to the sales tax. See *Rhoades v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

By complementing the sales tax, the use tax ensures that non-exempt retail transactions (particularly out-of-state retail transactions) that escape sales tax liability are nevertheless taxed. *Id.* at 1047; *USAir, Inc. v. Ind. Dep't of State Revenue*, 623 N.E.2d 466, 468–69 (Ind. Tax Ct. 1993). The use tax ensures that, after such goods arrive in Indiana, the retail purchasers of the goods bear their fair share of the tax burden. To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. *Rhoades*, 774 N.E.2d at 1048. A taxable retail transaction occurs when; (1) a party acquires tangible

personal property as part of its ordinary business for the purpose of reselling the property; (2) that property is then exchanged between parties for consideration; and (3) the property is used in Indiana. See IC § 6-2.5-1-2; IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-1(a); IC § 6-2.5-3-2(a); IC § 6-2.5-4-1(b), (c).

Nonetheless, Taxpayer argues that its purchases of the various lotions and ointments were "non-legend drugs" and fall within the exemption set out in IC § 6-2.5-5-19 (2003) as follows:

(a) As used in this section, "legend drug" means a drug as defined in [IC 6-2.5-1-17](#) that is also a legend drug for purposes of [IC 16-18-2-199](#).

(b) As used in this section, "nonlegend drug" means a drug (as defined in [IC 6-2.5-1-17](#)) that is not a legend drug.

(c) Sales of legend drugs and sales of nonlegend drugs are exempt from the state gross retail tax if:

(1) a registered pharmacist makes the sale upon the prescription of a practitioner who is licensed to prescribe, dispense, and administer those drugs to human beings or animals in the course of his professional practice; or

(2) the licensed practitioner makes the sales.

(d) Sales of a nonlegend drug are exempt from the state gross retail tax, if:

(1) the nonlegend drug is dispensed upon an original prescription or a drug order (as defined in [IC 16-42-19-3](#)); and

(2) the ultimate user of the drug is a person confined to a hospital or health care facility.

(e) Sales of insulin, oxygen, blood, or blood plasma are exempt from the state gross retail tax, if the purchaser purchases the insulin, oxygen, blood, or plasma for medical purposes.

(f) Sales of drugs, insulin, oxygen, blood, and blood plasma are exempt from the state gross retail tax if:

(1) the purchaser is a practitioner licensed to prescribe, dispense, and administer drugs to human beings or animals; and

(2) the purchaser buys the items for:

(A) direct consumption in his practice; or

(B) resale to a patient that the practitioner is treating, in the case of sales of legend or nonlegend drugs.

(Emphasis added).

IC § 6-2.5-5-19 (2003) like all tax exemption provisions, is strictly construed against exemption from the tax. *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282, 283 (Ind. Tax Ct. 1999); *Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629, 636 (Ind. Tax Ct. 1999); *Indiana Dept. of State Rev. v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988); *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Id.* at 100-101.

Nevertheless, the Department is well aware of the countervailing rule that a "statute must not be construed so narrowly that it does not give effect to legislative intent because the intent of the legislature embodied in a statute constitutes the law." *General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991).

In making its argument that it was entitled to purchase the lotions and ointments without paying sales tax, Taxpayer points to a previous version of IC § 6-2.5-5-19 (1980) which states:

(a). Sales of drugs are exempt from the state gross retail tax, if;

(1) a registered pharmacist makes the sale upon the prescription of a practitioner who is licensed to prescribe, dispense, and administer those drugs to human beings in the course of his professional practice; or

(2) the licensed practitioner makes the sales.

(b). Sales of insulin, oxygen, blood, or blood plasma are exempt from the state gross retail tax, if the purchaser purchases the insulin, oxygen, blood, or plasma for medical purposes.

(c). Sales of drugs, insulin, oxygen, blood, and blood plasma are exempt from the state gross retail tax, if:

(1) The purchaser is a practitioner licensed to prescribe, dispense, and administer drugs to humans or animals;

(2) The purchaser buys the items for direct consumption in his practice; and

(3) In the case of sales of drugs, the drugs may not be sold without a prescription.

Under IC § 6-2.5-5-19 (1980), a licensed practitioner's purchase of drugs was exempt when the drugs were purchased for direct consumption by the practitioner and the drugs could not be sold without a prescription. Under IC § 6-2.5-5-19 (1980), the legislature intended that only prescription drugs that were directly consumed by a licensed practitioner were exempt from Indiana sales/use tax.

The Department of Revenue issued regulations in 1982 addressing the issue of whether the purchase or sale of drugs is subject to sales/use tax.

[45 IAC 2.2-5-35](#) (1982) provides:

(a) In general, all purchases of tangible personal property by a licensed practitioner are subject to gross retail tax. This exemption is limited to sales of certain drugs, insulin, oxygen, blood and blood plasma.

(b) Sales to licensed practitioners, of drugs which may be sold only on a prescription are exempt from the gross retail tax if the practitioner buys the drugs for direct consumption in the course of rendering professional services.

(c) Sales to licensed practitioners of insulin, oxygen, blood, or blood plasma are exempt from the gross retail tax if the practitioner buys such items for direct consumption in the course of rendering professional service.

[45 IAC 2.2-5-36](#) (1982) provides:

(a) The gross retail tax shall apply to the following purchase transactions made by licensed practitioners:

- (1) All office furniture, equipment and supplies.
- (2) Drugs of a type not requiring a prescription, when not purchased for resale.
- (3) Surgical instruments, equipment and supplies.
- (4) Bandages, splints, and all other medical supplies consumed in professional use.
- (5) X-Ray, diathermy, diagnostic equipment, or any other apparatus used in the practice of surgery or medicine.

(b) The purchase of items for resale by the physician or surgeon. In order to resell items the practitioner must be licensed as a retail merchant, and must quote the selling price of any items separately from the charge for professional service.

[45 IAC 2.2-5-35](#) (1982) and [45 IAC 2.2-5-36](#) (1982), practitioners were entitled to purchase drugs without incurring sales/use tax. However, the exemption was only applicable to prescription drugs. If the drugs could be purchased without a prescription – such as "non-legend" drugs – the exemption was not applicable. The only way a practitioner could purchase non-legend drugs without paying tax was to purchase the drugs under a more general "purchase for resale" exemption, e.g. a doctor purchases aspirin to sell to the patients who visit her clinic.

It is Taxpayer's contention that the Department's regulations no longer accurately reflect the underlying legislative intent set out in IC § 6-2.5-5-19 (2003). Taxpayer points out that the legislature modified IC § 6-2.5-5-19 (1980) in 1994 and subsequently in 2003 and that the modifications entitle it to purchase non-legend drugs without paying sales/use tax. Specifically, Taxpayer points to IC § 6-2.5-5-19(d) (2003) which states:

(d) Sales of a nonlegend drug are exempt from the state gross retail tax, if:

- (1) the nonlegend drug is dispensed upon an original prescription or a drug order (as defined in [IC 16-42-19-3](#)); and
- (2) the ultimate user of the drug is a person confined to a hospital or health care facility.

Insofar as Taxpayer's protest, "non-legend" drugs are defined under IC § 6-2.5-1-17 as follows:

"Drug" means a compound, substance, or preparation and any component of a compound, substance, or preparation that is:

- (1) recognized in the official United States Pharmacopoeia, official Homeopathic Pharmacopoeia of the United States, or official National Formulary, and supplement to any of them;
- (2) intended for use in the diagnosis, cure, mitigation, treatment, or prevention of disease; or
- (3) intended to affect the structure or any function of the body.

The term does not include food and food ingredients, dietary supplements, or alcoholic beverages. (Emphasis added).

Taxpayer maintains that its purchase of topical substances – such as protective lotions, ointments, moisturizing cream – are non-legend drugs and fall within the exemption set out in IC § 6-2.5-5-19 (2003). Taxpayer is correct. The lotions and ointments fall within the definition of "drugs" under IC § 6-2.5-1-17(3) because they cure, mitigate or treat disease or "affect the structure or any function of the body," are prescribed pursuant to IC § 16-42-19-3, and "the ultimate user of the drug is a person confined to a hospital or health care facility." IC § 6-2.5-5-19(d)(2) (2003). However, it should be noted that the exemption does not cover the use of non-legend drugs outside of Taxpayer's facility. To the extent that Taxpayer prescribes non-legend drugs to patients residing within its care facilities, Taxpayer's purchases of those drugs are exempt from sales/use tax.

FINDING

Taxpayer's protest is sustained.

II. Medical Supplies and Equipment – Gross Retail Tax.

DISCUSSION

The Department's audit found that Taxpayer purchased "IV supplies, syringes, catheters... wheelchairs, bariatric items, VAC units" and other medical supplies without paying sales tax. The Department's audit therefore assessed Taxpayer use tax on these items.

Taxpayer disagrees stating that the "medical items should be removed from the proposed assessment because they are exempt from tax and [Taxpayer] was told that they were not taxable."

As authority, the Department's audit cited to Sales Tax Information Bulletin 48 (August 2008), 20080827 Ind. Reg. 045080661NRA, which states:

In general, all purchases of tangible personal property by a licensed practitioner are subject to sales tax.

However, an exemption is afforded to purchases of certain drugs, insulin, oxygen, blood, and blood plasma. Purchases by licensed practitioners of drugs that can be sold only by prescription are exempt from sales tax if the practitioner buys the drugs for direct consumption in the course of rendering professional services.

Purchases by licensed practitioners of insulin, oxygen, blood, and blood plasma are exempt from the sales tax if the practitioner buys such items for direct consumption in the course of rendering professional services. Drugs, insulin, oxygen, blood, and blood plasma consumed in the course of rendering professional services are those drugs, etc., that are administered by a licensed practitioner or agent including the furnishing of such drugs as a part of a single charge for professional service. (Emphasis added).

Taxpayer indicates that it relied upon previous guidance by the Department instructing it that the purchase of medical supplies was exempt. As specific statutory authority for its position that the purchase of the equipment and supplies was exempt, Taxpayer cites to IC § 6-2.5-5-18 which states:

(a) Sales or rentals of durable medical equipment, mobility enhancing equipment, prosthetic devices, artificial limbs, orthopedic devices, dental prosthetic devices, eyeglasses, contact lenses, and other medical supplies and devices are exempt from the state gross retail tax, if the sales or rentals are prescribed by a person licensed to issue the prescription.

(b) Sales of hearing aids are exempt from the state gross retail tax if the hearing aids are fitted or dispensed by a person licensed or registered for that purpose. In addition, sales of hearing aid parts, attachments, or accessories are exempt from the state gross retail tax. For purposes of this subsection, a hearing aid is a device which is worn on the body and which is designed to aid, improve, or correct defective human hearing.

(c) Sales of colostomy bags, ileostomy bags, and the medical equipment, supplies, and devices used in conjunction with those bags are exempt from the state gross retail tax.

(d) Sales of equipment and devices used to administer insulin are exempt from the state gross retail tax.

(e) Sales of equipment and devices used to monitor blood glucose level, including blood glucose meters and measuring strips, lancets, and other similar diabetic supplies, are exempt from the state gross retail tax, regardless of whether the equipment and devices are prescribed.

Therefore, sales of "durable medical equipment" and supplies may be exempt if the equipment is "prescribed." (The statute also specifically exempts certain items such as diabetic supplies whether or not they are prescribed.) The Department's regulation, [45 IAC 2.2-5-27](#), explains:

(a) The term "person licensed to issue a prescription" shall include only those persons licensed or registered to fit and/or dispense such devices. (b) Definition: The term "prescribed" shall mean the issuance by a person described in paragraph 1 of this regulation [subsection (a) of this section] of a certification in writing that the use of the medical equipment supplies and devices is necessary to the purchaser in order to correct or to alleviate a condition brought about by injury to, malfunction of, or removal of a portion of the purchaser's body. (Emphasis added).

Under IC § 6-2.5-5-18(a) and [45 IAC 2.2-5-27](#), a person having a "condition brought about by injury, malfunction of, or removal of a portion of the purchaser's body," may be eligible for a sales tax exemption if the "person" receives a proper prescription for the "medical equipment supplies and devices."

Under IC § 6-2.5-5-18(a) and [45 IAC 2.2-5-28](#), sales of prescribed "medical equipment, supplies, or devices" are exempt if they are necessary to "correct or alleviate injury to, malfunction of, or removal of a portion of the purchaser's body."

In this case, the transactions were between Taxpayer and its various vendors. Taxpayer was the purchaser but did not sustain a "condition brought about by injury to, malfunction of, or removal of a portion of the purchaser's body." See [45 IAC 2.2-5-27\(b\)](#).

Taxpayer provides long-term medical care; its purchases of the "IV supplies, syringes, catheters... wheelchairs, bariatric items [and] VAC units" are more appropriately addressed at [45 IAC 2.2-5-36](#) which states:

(a) The gross retail tax shall apply to the following purchase transactions made by licensed practitioners:

(1) All office furniture, equipment and supplies.

(2) Drugs of a type not requiring a prescription, when not purchased for resale.

(3) Surgical instruments, equipment and supplies.

(4) Bandages, splints, and all other medical supplies consumed in professional use.

(5) X-Ray, diathermy, diagnostic equipment, or any other apparatus used in the practice of surgery or medicine.

(b) The purchase of items for resale by the physician or surgeon. In order to resell items the practitioner must be licensed as a retail merchant, and must quote the selling price of any items separately from the charge for professional service. (Emphasis added).

The "IV supplies, syringes, catheters... wheelchairs, bariatric items [and] VAC units" fall within [45 IAC 2.2-5-36\(a\)\(5\)](#) as "apparatus used in the practice of surgery or medicine" and are plainly "medical supplies consumed in professional use" as defined under [45 IAC 2.2-5-36\(a\)\(4\)](#). There is no indication that any of the items were ever resold to individual patients or that Taxpayer – as a long-term medical care facility – ever quoted its patients a selling price for these items.

According to Taxpayer that IC § 6-2.5-5-18, "exempts sales of medical supplies, if the sales are prescribed by a person licensed to issue the prescription" and that "the medical supplies listed in the audit were prescribed by [Taxpayer] a licensed medical practitioner."

The Department does not agree with Taxpayer's conclusion but points to [45 IAC 2.2-5-27\(b\)](#) which explains:

The term "prescribed" shall mean the issuance by a person described in paragraph 1 of this regulation [subsection (a) of this section] of a certification in writing that the use of the medical equipment supplies and devices is necessary to the purchaser in order to correct or to alleviate a condition brought about by injury to, malfunction of, or removal of a portion of the purchaser's body.

[45 IAC 2.2-5-27](#)(b) plainly states that, in order to qualify for the exemption, the use of the medical equipment supplies and devices is necessary to the purchaser in order to correct or to alleviate a condition brought about by injury to, malfunction of, or removal of a portion of the purchaser's body. In this case, the purchaser is Taxpayer. Taxpayer is an extended care facility and has no body upon which medical equipment, supplies, or devices may be used. Rather, Taxpayer purchases the equipment and uses it in providing medical services to its patients. Taxpayer has failed to meet its burden under IC § 6-8.1-5-1(c) of demonstrating that the proposed assessment was wrong.

Nonetheless, Taxpayer argues that it is entitled to prospective enforcement of the Department's position because it relied on a previous Letter of Findings, issued in 2006, which contradicts the Department's current position. Taxpayer points to Letter of Findings 97-0111 (August 31, 1998) and Letter of Findings 05-0297 (December 1, 2006). In those Letters of Finding, the Department sustained the Taxpayer on the issue of whether IV supplies, respiratory supplies, and "intrusive" supplies were subject to sales tax. In addition, Taxpayer cites to a Departmental Revenue Ruling 1998-02 (February 6, 1998) in which the Department found "the sale of [coronary] stents separately from [a] coronary angioplasty balloon catheter is not subject to sales/use tax."

However, the cited ruling has been superseded and replaced by rulings correctly indicating that the property in question was not exempt from sales tax. See Revenue Ruling 2009-16ST (December 1, 2009) (repealing Revenue Ruling 2008-03ST); Revenue Ruling 2009-17ST (December 1, 2009) (ruling that heart catheters and machines are subject to Indiana sales and use tax); Revenue Ruling 2010-01ST (January 11, 2010) (repealing Revenue Ruling 2008-17ST); Revenue Ruling 2010-02ST (February 18, 2010) (ruling that surgical cutting equipment employed in orthopedic surgery was taxable).

In addition, the exemption for medical equipment and supplies under IC § 6-2.5-5-18 sets out a prerequisite to qualify for the exemption; the sale or rental itself must be prescribed by a person licensed to issue the prescription. While Letter of Findings 97-0111 concluded that certain supplies and equipment were exempt from sales tax, this Letters of Findings did not discuss the prescription requirement as it related to the disputed items. The Letters of Findings cited to a test that is unsupported by statute, regulation, or case law. However, Letter of Findings 05-0297 correctly applied the portion of the test requiring a prescription. Further, the Department has issued three Letters of Findings correctly stating that the requirement for the exemption under IC § 6-2.5-5-18(a) and (b) is that the property be sold pursuant to a prescription by a licensed professional. See Letter of Findings 08-0531 (February 2, 2009); Letter of Findings 09-0192 (November 30, 2009); Letter of Findings 09-0223 (November 30, 2009).

In summary, Taxpayer has cited as primary authority two Letters of Findings that did not apply the proper test applicable under Indiana statutes and regulations and a Revenue Ruling that has been revoked and overruled by Revenue Rulings standing for the opposite proposition cited by Taxpayer. Further, the Department has issued seven Revenue Rulings and four Letters of Findings within the last twelve years each of which stands for the proposition that an exempt sale under IC § 6-2.5-5-18 must be made to the purchaser pursuant to a prescription. However, a sale to a purchaser – such as a hospital or similar facility – which subsequently uses the property is not a sale to that purchaser pursuant to a prescription and thus the exemptions under IC § 6-2.5-5-18(a) and (b) are inapplicable.

It should be noted that Taxpayer's accounting records for purchases of intravenous products included both exempt prescription items and non-exempt supplies such as an intravenous pumps and poles. Because exempt drugs and non-exempt equipment and supplies were included in the intermingled same account, The audit and the [T]axpayer examined a selection of these invoices and determined that they contained approximately 75[percent] prescription drugs and 25[percent] taxable supplies. Insofar as the intra-venous items, this Letter of Findings finds no reason to depart from that determination.

FINDING

Taxpayer's protest is respectfully denied.

SUMMARY

To the extent that Taxpayer prescribes non-legend drugs to its long-term and rehabilitative health care patients, Taxpayer's protest is sustained; in all other respects, Taxpayer's protest is respectfully denied.

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